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The Business Environment in Ukraine: Before and after 2008

What should businesses in Ukraine expect in 2008? What were the conditions for doing business in 2007 and are there any reasons for change in 2008? We asked ICPS economist Hanna Cherednychenko about the realities of the Ukrainian business environment today

ICPS: What business development trends did you see in 2007?

Hanna Cherednychenko: In my opinion, 2007 was a good year for doing business in Ukraine. Small, medium and large businesses grew at a rapid pace and the majority of economic sectors also posted serious growth. Conditions were apparently favorable for the development of nearly all businesses. One of the strongest factors behind this was the continuing rapid development of the domestic market. This provided and will continue to provide opportunities to expand, not only to large export-oriented companies, but also to SMEs producing mainly to meet domestic household and business demand. Overall, this growing domestic market is good for economic development, as it makes the economy more resistant to external shocks.

ICPS: How would you qualify how successful 2007 was for business?

HC: There are a number of indicators that are used to evaluate the health of businesses. It's worth pointing out that fixed capital investment grew very fast in 2007. According to our estimates, gross accumulation of fixed capital grew 23%, which is a record-high economic indicator for the entire period since Ukraine gained independence in 1991. Rapidly growing investment indicates that businesspeople see prospects for developing their businesses, hope for high demand for their products, and motivation to improve production technologies in order to remain competitive.

ICPS: Which sectors invested the most actively?

HC: We saw lively investment activity among enterprises in nearly all sectors. One pronounced trend of 2007 was a significant acceleration of investment in industrial fixed capital, compared to 2006. Investment in this

sector grew nearly 50% in real terms. This was the result of both the fact that businesses were trying to improve their competitiveness by upgrading production facilities—as we all know, the plant in Ukrainian industry is extremely depreciated—and that they needed to expand production capacities. Demand for industrial products has been growing on both the domestic and external markets.

ICPS: What are the main obstacles to developing business at the moment?

HC: In addition to Ukraine's long-standing problems, such as the flawed regulatory environment, unpredictable policy, and the lack of a good infrastructure, many companies faced a fairly unusual problem for Ukraine in 2007—a shortage of labor. This means it has become quite difficult to find skilled workers for a slew of professions and hiring certain specialists is now very expensive for companies.

In this kind of situation, companies are often forced to hire employees who lack the necessary education and skills. This means they have to spend both time and money to train these employees. As businesses can't always afford this, sometimes, they have to suffer the low quality of services these new employees provide.

ICPS: What can the government do to resolve this problem?

HC: A lot. The government can and should look for ways to resolve this problem, because it will affect the quality and pace of overall economic growth. One of the main factors causing this unbalanced labor market is the situation with state-run higher learning: in terms of both quality and structure, specialized training largely fails to meet the needs of today's economy. If this situation continues for a long period of time, eventually, it will become a serious restriction on business growth.

I think businesses and the government should work together to resolve this problem. At a minimum, the government could use the help of specialists from the private sector to try to develop more realistic forecasts for demand and supply on the labor market and, accordingly, to adjust the way specialists are trained. Obviously, it also makes sense to provide incentives to students and teachers of those professions that may not be popular now, but are highly likely to be in demand several years down the line.

ICPS: How did the regulatory environment improve in 2007?

HC: There weren't any radical changes, although there was a little progress. The government took some steps to improve the permit system and the state oversight system. There are some initiatives to improve the regulation of licensing, standardization and certification. On the whole, changes are taking place at a much slower pace than businesses had hoped. As the economy grows rapidly, progresses and becomes more complex and the cost of flaws in the regulatory environment goes up, the government's efforts to reform the regulatory environment are not increasing seriously.

ICPS: What will be the key business development trends in 2008?

HC: I think that, overall, the strongest trends in 2007 will continue and possibly grow stronger: lively expansion and optimistic expectations among businesses, dynamic investment, and high demand for labor. An additional spur to growth will be the beginning of preparations for the 2012 European Football Championship. At the same time, we don't expect the government to find the courage to institute those transformations that could significantly improve the business environment. ■

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LGI Fellowship Program teaches how to analyze public policy

A series of studies called “Decentralization in Effect: Five examples from CIS countries” was published as part of the “LGI 2006/2007 Policy Fellowship for Russian-speaking specialists” project. In this publication, participating fellows analyze public policy in their countries and offer recommendation for improving it

The LGI Fellowship Program

For the second year in a row, the International Centre for Policy Studies coordinated the “LGI Policy Fellowship for Russian-speaking specialists” project funded by the Local Government and Public Service Reform Initiative of the Open Society Institute (OSI) in Budapest. The goal of this program is to improve the qualifications of young Russian-speaking experts on government issues regarding public policy analysis and decision-making at the local and regional levels. In this way, LGI works to support practical policy reforms in the region.

LGI 2006/2007 Policy Fellowship, implemented over 12 months, consisted of two intensive group seminars dedicated to writing effective policy analysis briefs and organizing the lobbying process.

Fellows were selected from five countries in the Former Soviet Union: two civil servants from the Ministry of Finance of Ukraine, three analysts and project managers from NGOs in Armenia, Kazakhstan and Kyrgyzstan, and a Russian researcher from the Rostov State University.

Public policy analysis

Public policy analysis is the systematic comparison and evaluation of options that are proposed to politicians to resolve social problems. In the Soviet Union, this was poorly developed—especially at the local level.

The powerful government chain-of-command cared little for the development of public policy analysis. What information about local social and economic problems was available tended to be unreliable and frequently distorted. Finally, demonstrative “discussions” took the place of serious debates within the ruling party.

Since the beginning of the 1990s, the situation with public policy analysis has slowly been changing for the better. But so far, the studying of public policy processes has not been integrated into the curriculum

for educating and training civil servants in the majority of FSU countries.

In this context, the papers by LGI fellows presented in this collection constitute an innovative product that could be useful to both researchers and practitioners in the civil service.

The fellows’ recommendations

The first paper, written by Armenia’s Artur Aivazov, emphasizes the problem with small town development and the need for the national Government to implement a more effective policy in this area. Mr. Aivazov analyzes the problems of implementing existing public policy to facilitate cooperation among municipalities. Drawing on international experience and the experience of contacts with Armenian city leaders, Mr. Aivazov recommends strengthening the legal base for similar cooperation and providing municipalities incentives in this area.

In Kazakhstan, **Maria Gorokhova** also studies small town issues, but is constantly faced with shifting public policy. The country is large, while settlements are scattered too far apart from each other to combine efforts or cooperate effectively. Moreover, the institution of local government is actually poorly developed, especially at the level of little towns. Ms. Gorokhova’s recommendations suggest strengthening the autonomy of small towns, which should establish the conditions necessary for their economic and social revival.

Mamatkalil Razayev focuses his attention on public consultations in the decision-making process among local governments in Kyrgyzstan. Mr. Razayev insists that the fact that the state favors the idea of strong local government will, on its own, not yield results unless voters are encouraged to more actively participate in the decision-making process. At the moment, local governments have neither an effective legislative base nor practical guidelines to allow the more active participation

of voters. Mr. Razayev offers detailed recommendations for how to organize public consultations in practice.

There is no city or town in the Former Soviet Union that does not suffer from serious problems with investment in municipal infrastructure. This issue is examined by **Anna Yermishina** from Rostov-on-Don. As an example, Ms. Yermishina used Rostov-on-Don’s water supply management crisis. Ms. Yermishina proposes setting up a consultative structure that, in her opinion, should be able to wield real power, with due consideration for the opinions of all stakeholders.

Ukraine’s **Kateryna Zubanova and Oleksiy Zhak** take a look at how to coordinate the planning processes among local or regional governments within the restrictions of available budgets. During the soviet and post-soviet eras, planning processes were traditionally viewed by officials and the public with great skepticism, as resources were never taken into account. The recently fashionable drafting of local or regional development strategies is currently facing this same problem. Using their knowledge and best international practice, Ms. Zubanova and Mr. Zhak, both professionals in the Ministry of Finance of Ukraine, propose a proprietary methodology, according to which the fulfillment of a development strategy should intersect with the planning of the relevant budget for a year, or even longer. ■

A full version of this document, written in Russian, can be downloaded from the ICPS website at: <http://www.icps.com.ua/doc/LGI%20Fellowship%20report%20RUS.pdf>. In 2006, LGI set up its first fellowship for Russian-speaking specialists. Participants in this fellowship program can be nationals from all former soviet republics, except for the Baltic countries. Participants work in small teams under the guidance of an experienced mentor to establish the results of these studies and policy analysis in a specific area, develop specific recommendations, and implement them.

The next call for proposals for LGI Fellowships for 2008–2009 will be announced shortly. For additional information, contact Project Manager Olha Shumylo by telephone at (380-44) 484-4400 or via e-mail at oshumylo@icps.kiev.ua.

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